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E.O. 12958: DECL: 06/02/2018
TAGS: PGOV PREL EPET TX
SUBJECT: TURKMENISTAN'S PETROLEUM LAW UNDER REVISION

Classified By: Charge d'Affaires Sylvia Reed Curran for reasons 1.4(B) and (D).

¶1. (C) SUMMARY: Turkmenistan's hydrocarbon agencies are working on changes to the country's Petroleum Law. One set of changes would seek to address major complaints by subcontractors in the hydrocarbon sector, exempting them from paying value-added and many other taxes, and making it easier for hydrocarbon subcontractors to function in Turkmenistan. The other set of changes would be to expand contract formats from the current selection of joint ventures and production sharing agreements to include risk sharing agreements and -- possibly -- guaranteed production contracts. The current proposals to the Petroleum Law indicate a possible move on the part of Turkmenistan's government toward a more open investment regime. However, it is not yet clear whether these changes -- and contractual formats -- will also be applied to onshore gas fields. END SUMMARY.

¶2. (C) According to a source at Turkmenistan's State Agency for Management and Use of Hydrocarbon Resources, the country's Petroleum Law is undergoing revision. Those revising the law are focusing on regulating operations of petroleum subcontractors and introduce new oil and gas contract formats. It is unclear when the revised law will be ready for review -- and approval -- by Turkmenistan's parliament.

WHY CHANGE?

¶3. (SBU) The official said that the revisions were prompted by the influx of proposals for cooperation from foreign companies that the State Agency received last year. In addition to those proposals, the State Agency has also been studying research papers on various contract structures.

PETROLEUM SUBCONTRACTORS WOULD GAIN ADVANTAGES

¶4. (SBU) Proposed changes to the law aim to rid the existing

gap in the legal treatment of petroleum subcontractors and their activities. According to the State Agency official, changes would subject subcontractors only to the 20% income tax, while exempting them from paying other taxes, such as the 15% value-added tax. By comparison, services in other sectors that are not solely related to petroleum would be subject to all applicable taxes.

¶5. (SBU) It is still unclear whether subcontractors' operations will be primarily regulated by the Petroleum Law and therefore be overseen by the State Agency. However, the State Agency source indicated informally that the State Agency would propose that all subcontractors follow Turkmenistan's "Rules and Regulations for the Development of Hydrocarbon Fields," sometimes referred to as petroleum operations rules. The operations rules were adopted in 1999 for production sharing agreement operators/contractors and govern all stages of petroleum activities. The operations rules also require companies to obtain permits from the State Agency for geophysical surveys, well drilling, well completion, well workover operations, offshore construction and abandonment.

TYPES OF CONTRACTS

¶6. (C) The current draft Petroleum Law provides for four types of contracts: the production sharing agreement, Joint Venture/Joint Operations Agreement, both of which are already recognized within Turkmenistan's current Petroleum Law, and a new type of contract, the Risk Service Contract. The Risk Service Contract is already used in Turkmenistan, but would

be governed by the Petroleum Law.

JOINT VENTURES

¶7. (SBU) Although this model was one format recognized in the Petroleum Law of 1996, Turkmenistan presently does not have any petroleum joint ventures. Turkmenistan sees joint ventures as a good vehicle for training its petroleum personnel. In addition, it can provide necessary capital for increasing production. The new law would allow the State Agency, Turkmenoil, Turkmengas and other state enterprises to become joint venture partners. The Law on Foreign Investment in Turkmenistan requires foreign partners to have at least a 20% share in a joint venture.

RISK SERVICE COTNRACTS

¶8. (SBU) Risk service contracts require the contractor to finance exploration and development of petroleum fields. If exploration is a success, the contractor will be entitled to a profit calculated as a percentage of petroleum sales revenue minus the contractor's costs. Risk service contracts are similar to production sharing agreements, but the risk service contracts share profits, rather than petroleum.

OTHER FORMATS UNDER CONSIDERATION

¶9. (C) Although not strictly an risk service contract, the State Agency is also planning to propose an addition of a guaranteed production contract. The contractor would undertake to produce a certain tonnage of oil or pay a fine for the oil not delivered. (COMMENT: The source at the State Agency did not specify how such services would be rewarded, but the most likely solution would be for such a reward to be focused on the crude produced in excess of the contracted volume. END COMMENT.) These contracts are most likely to be used for fields with depleting oil reserves, such as those in Balkan Province, located in western Turkmenistan.

¶10. (C) COMMENT: Several government agencies are involved in the review of the Petroleum Law. Although the State Agency, as the entity responsible for implementing the

Petroleum Law, takes the lead in the process, some of the Agency's proposed amendments, such as those for Profit Sharing Agreements, have been rejected. The current proposals to the Petroleum Law indicate a possible move on the part of Turkmenistan's government toward a more open investment regime. However, it is not yet clear whether these changes -- and contractual formats -- will also be applied to onshore gas fields. END COMMENT.
CURRAN